TRANSACTIONS OF SOCIETY OF ACTUARIES
1960 VOL. 12 NO. 33

Pension and Retirement Plans

A. To what extent has the recent change in the federal income tax law helped to equalize the competitive position of insured pension plans as compared with trusteed pension plans?

B. In distributing surplus or retroactive credits on group annuity contracts, what are the advantages and disadvantages of recognizing the rate of interest by year of investment?

C. How can lump sum and contingent annuity options best be offered so that they meet the desires of the employer and protect the plan against adverse selection?

MR. WILLIAM M. RAE described a method adopted by the Bankers Life of Des Moines for allocating interest among lines of business and within the group pension line to a group pension policyholder in the calculation of his dividend. This method takes into account the time when money is received from a class of policyholders and the actual earnings on that money and reflects such earnings to that class of policyholders. He referred to it as the Investment Year Interest method.

Mr. Rae explained that in allocating interest among lines of business they were in effect allocating the interest arising from investments made in a particular year, adjusted for reinvestment, in proportion to the mean funds arising that same year from the various lines of business.

He felt that the Investment Year Interest method was more realistic and more equitable than the across-the-board average rate method. He said that the average rate method invites severe selection against insurers by sophisticated pension buyers. When new money rates are high, employers tend to put money with a trust. The insurer never gets the opportunity to invest it at favorable interest rates. When new money rates are low, employers tend to surfeit an insurer with pension money, thus rapidly reducing the average earnings rate of the insurer.

Mr. Rae added that the Investment Year Interest method did not involve any segregation of assets and was clearly within the contribution theory of determining dividends.

MR. RONALD LEROY supported the method of crediting interest in a way which recognizes the year of investment. He expressed the opinion that this new method is more equitable, is readily understood, and assists in the sale of new business.

MR. HOWARD H. HENNINGTON discussed the recent changes of the federal income tax law and referred to the fact that the benefits of the law are being passed on to policyholders in the form of lower purchase payment rates and increased dividends. He referred to the need for further correction in three areas: elimination of the tax on capital gains associated with qualified pension plans, elimination of the tax on gains from operations with respect to qualified pension plans, and elimination of the tax on investment earnings with respect to surplus associated with qualified pension plans.

Mr. Hennington also discussed lump sum and contingent annuity options. He supported the use of a five year notice period for the election of the joint and survivor option as against shorter notice periods. He indicated that an employee should be able to appraise his financial circumstances five years in advance and that shorter notice periods are of interest primarily where a change in health motivates the joint and survivor election. The cost of a short notice requirement is particularly significant if it applies to joint and survivor elections effective at early retirement dates as well as at normal retirement date. He also cautioned against joint and survivor arrangements where the benefit becomes effective not at a date fixed in advance but on actual retirement. This creates severe administration problems and can be subject to serious abuse.

In connection with lump sum options, Mr. Hennington referred to the difficulty of an advance notice requirement. He indicated that one arrangement which his Company has used involves the election of an annuity form involving a death benefit equal to the return of the purchase payments accumulated at interest. Under this annuity form it becomes much more feasible to permit a lump sum election without a requirement of advance notice or health evidence.

MR. JAMES A. ATTWOOD referred to an increasing interest in lump sum and contingent annuity options. Many employers view the addition of options as a means of improving the pension plan without adding to the cost of the pension plan. The capital gains treatment of lump sum settlements is a strong factor in stimulating the desire for such options. A general interest in introducing death benefits under pension plans is also present. Mr. Attwood discussed the difficulties in determining the proper value for the lump sum and suggested that the best value in most circumstances may be the lowest rate obtained from a responsible insurance company on a nonparticipating basis.

In connection with the contingent annuity option, Mr. Attwood emphasized the inequities which result from short notice election periods. He mentioned the advantages of introducing preretirement widows' benefits to avoid abuse of the contingent annuitant option.